

Internal Revenue Service

Number: **201229007**
Release Date: 7/20/2012
Index Number: 1362.02-03

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

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Refer Reply To:
CC:PSI:B03
PLR-143408-11
Date: March 22, 2012

LEGEND

X =

A =

State =

Date =

1

Date =

2

Year =

1

Year =

2

n1 =

n2 =

n3 =

n4 =

Dear :

This letter responds to a letter dated October 10, 2011, and subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting

a ruling that rental income received by X from certain rental real estate is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code.

FACTS

The information submitted states that X was incorporated under the laws of State on Date 1. X owns a certain commercial and rental real estate property located at A (the "Property"), which it leases to tenants. X expects to have accumulated earnings and profits from prior years. X intends to elect to be treated as an S corporation for federal tax purposes effective Date 2.

X, through its employees and other agents, provides certain services with respect to the Property. These services involve maintaining and repairing the Property, including its common areas and grounds. Maintenance includes cleaning, painting, electrical, plumbing, roof and structural maintenance, garbage and recycling, landscaping services, and pest control services. X, through its employees and through contractors, also furnishes the following operational and management services: identifying new tenants; negotiating leases; renewals and other agreements with tenants; collecting rents and other amounts due from tenants; communicating with tenants on all issues relating to management and operation of the Property; paying all water, gas, heat, light, power, sewer, and janitorial charge and other utilities or services used or needed for the Property; maintaining the structural and exterior portions of the Property in good condition; providing trash removal and window cleaning services; furnishing the Property-related inspections; maintenance of common areas; furnishing of landscaping and snow removal services.

For the tax years ending in Year 1 and Year 2, X collected approximately \$n1 and \$n2, respectively, in gross rents and paid or incurred approximately \$n3 and \$n4, respectively, in relevant operating expenses excluding depreciation.

LAW AND ANALYSIS

Section 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1362(d)(3)(A)(i) provides that an S corporation election shall be terminated whenever the corporation (I) has accumulated earnings and profits at the close of each of 3 consecutive taxable years, and (II) has gross receipts for each of such taxable years more than 25 percent of which are passive investment income.

Except as otherwise provided in § 1362(d)(3)(C), § 1362(d)(3)(C)(i) provides that the term "passive investment income" means gross receipts derived from royalties,

rents, dividends, interest, annuities, and sales or exchanges of stock or securities.

Section 1.1362-2(c)(5) of the Income Tax Regulations provides, in relevant part, that in general “passive investment income” means gross receipts derived from rent. Section 1.1362-2(c)(5)(ii)(B)(1) defines “rent” as amounts received for the use of, or right to use, property (whether real or personal) of the corporation. Section 1.1362-2(c)(5)(ii)(B)(2) provides that the term “rents” does not include rents derived in the active trade or business of renting property. Rents are derived in an active trade or business of renting property only if, based on all the facts and circumstances, the corporation provides significant services or incurs substantial costs in the rental business. Generally, significant services are not rendered and substantial costs are not incurred in connection with net leases. Whether significant services are performed or substantial costs are incurred in the rental business is determined based upon all the facts and circumstances including, but not limited to, the number of persons employed to provide the services and types and amounts of costs and expenses incurred (other than depreciation).

CONCLUSION

Based solely on the facts and representations submitted, we conclude that the rental income X receives from leasing the Property is not passive investment income as described in § 1362(d)(3)(C)(i).

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion on whether X is a small business corporation under § 1361(b). Further, the passive investment income rules of § 1362 are independent of the passive activity rules of § 469; unless an exception under § 469 applies, the rental activity remains passive for purposes of § 469.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with a power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the ruling request, it is subject to verification on examination.

Sincerely,

James A. Quinn
Senior Counsel, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2):

Copy of this letter
Copy for § 6110 purposes